

Internal Revenue Service, Treasury

§ 1.994-1

(6) Interest received by N on producer's loans	200
(7) Proceeds received by N representing recognized gain (but not losses) from sales of business assets located outside the United States	250
(8) N's gross receipts	3,550

[T.D. 7514, 42 FR 55468, Oct. 17, 1977]

§ 1.993-7 Definition of United States.

Under section 993(g), the term "United States" includes the States, the District of Columbia, the Commonwealth of Puerto Rico, and possessions of the United States. For the requirement that a DISC must be incorporated and existing under the laws of a State or the District of Columbia, see § 1.992-1(a)(1).

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§ 1.994-1 Inter-company pricing rules for DISC's.

(a) *In general*—(1) *Scope*. In the case of a transaction described in paragraph (b) of this section, section 994 permits a person related to a DISC to determine the allowable transfer price charged the DISC (or commission paid the DISC) by its choice of three methods described in paragraph (c)(2), (3), and (4) of this section: The "4 percent" gross receipts method, the "50-50" combined taxable income method, and the section 482 method. Under the first two methods, the DISC is entitled to 10 percent of its export promotion expenses as additional taxable income. When the gross receipts method or combined taxable income method is applied to a transaction, the Commissioner may not make distributions, apportionments, or allocations as provided by section 482 and the regulations thereunder. For rules as to certain "incomplete transactions" and for computing combined taxable income, see paragraph (c)(5) and (6) of this section. Grouping of transactions for purposes of applying the method chosen is provided by paragraph (c)(7) of this section. The rules in paragraph (c) of this section are directly applicable only in the case of sales or exchanges of export property to a DISC for resale, and are applicable by analogy to leases, commissions, and services as provided in paragraph (d) of this section. For rules limiting the application of the gross receipts method and combined taxable

income method so that the supplier related to the DISC will not incur a loss on transactions, see paragraph (e)(1) of this section. Paragraph (e)(2) of this section provides for the applicability of section 482 to resales by the DISC to related persons. Paragraph (e)(3) of this section provides for the time by which a reasonable estimate of the transfer price (including commissions and other payments) should be paid. The subsequent determination and further adjustments to transfer prices are set forth in paragraph (e)(4) of this section. Export promotion expenses are defined in paragraph (f) of this section. Paragraph (g) of this section has several examples illustrating the provisions of this section. Section 1.994-2 prescribes the marginal costing rules authorized by section 994(b)(2).

(2) *Performance of substantial economic functions*. The application of section 994(a)(1) or (2) does not depend on the extent to which the DISC performs substantial economic functions (except with respect to export promotion expenses). See paragraph (1) of § 1.993-1.

(3) *Related party and related supplier*. For the purposes of this section—

(i) The term "related party" means a person which is owned or controlled directly or indirectly by the same interests as the DISC within the meaning of section 482 and § 1.482-1(a).

(ii) The term "related supplier" means a related party which singly engages in a transaction directly with the DISC which is subject to the rules of section 994 and this section. However, a DISC may have different related suppliers with respect to different transactions. If, for example, X owns all the stock of Y, a corporation, and of Z, a DISC, and sells a product to Y which is resold to Z, only Y is the related supplier of Z, and, thus, only the resale from Y to Z is subject to section 994 and this section. If, however, X sells directly to Z and Y also sells directly to Z, then, as to the transactions involving direct sales to Z, each of X and Y is a related supplier of Z.

(b) *Transactions to which section 994 applies*. Section 994(a)(3) may be applied, as described in paragraph (a) of this section, to any transaction between a related supplier and a DISC. Section 994(a)(1) or (2) may be applied,